



TAX FACTS

From the
State of Hawaii, Department of Taxation

PARENT-TEACHER ORGANIZATIONS

December, 1999 AND OTHER SCHOOL-RELATED ORGANIZATIONS

99-4

Parent-teacher organizations, athletic and band booster organizations, school clubs, and other nonprofit, school-related organizations play an important role in the education of Hawaii's children in pre-kindergarten through grade 12. The Department of Taxation recognizes the difficulties such organizations encounter in maintaining organizational records and in meeting tax obligations as the officers and membership change over the years. This issue of Tax Facts provides general tax information that the parents, teachers, and students who give their time and energy to these organizations need to be aware of. For the tax treatment of nonprofit organizations in general, see Tax Facts No. 98-3, "Tax Issues for Hawaii Nonprofit Organizations."

Included in this issue of Tax Facts is information on a number of topics beginning with a section on how to form a nonprofit, school-related organization. The second section addresses federal and State income taxes, and includes subsections on obtaining exemption from federal and Hawaii income taxes, income tax filing requirements, and donations. The third section addresses the Hawaii general excise tax, and includes subsections on obtaining exemption from the general excise tax, fundraising, and general excise tax registration and filing requirements. The fourth section addresses the often overlooked Hawaii use tax that is levied on goods and services imported into Hawaii, and the fifth and final section addresses compliance issues.

The following are commonly asked questions and answers regarding the application of Hawaii tax laws to nonprofit, school-related organizations.

NOTE: Public schools are government agencies and exempt from federal and state tax requirements other than those required as an employer. FUNDRAISING ACTIVITIES CONDUCTED DIRECTLY BY PUBLIC SCHOOL ORGANIZATIONS SUCH AS YEARBOOK AND NEWSWRITING ORGANIZATIONS, STUDENT CLUBS, PEP SQUADS, STUDENT GOVERNMENT ORGANIZATIONS, ETC., IN WHICH ALL PROCEEDS ARE PAID INTO, PROCESSED, AND DISBURSED FROM THE PUBLIC SCHOOL'S NON-APPROPRIATED SCHOOL FUND CHECKING ACCOUNT ARE NOT TAXED ON THOSE DEPOSITS. Contact school administrators regarding the use of the school's non-appropriated school fund checking account. For more information, see Tax Information Release No. 89-6.

FORMING A NONPROFIT, SCHOOL-RELATED ORGANIZATION

1. A group of parents wants to form a nonprofit organization to provide financial assistance to support the local school. How do we form the organization?

You first need to decide what form the organization should take, and then prepare appropriate organizing documents. Usually, parent-teacher organizations and other school-related organizations are unincorporated associations, though some may organize as a corporate entity.

If the organization will be an unincorporated nonprofit association, you need not file any documents with the Department of Commerce and Consumer Affairs, but you should prepare an organizing document such as a constitution, articles of association, etc. This document must

be formally adopted and properly executed (i.e., signed and dated) by 2 or more persons.

To incorporate a nonprofit organization, prepare and file articles of incorporation with the State Department of Commerce and Consumer Affairs' Business Registration Office. The organization may use Form DNP-1 (formerly Form D2-1), Articles of Incorporation (for Domestic Nonprofit Organizations), or write its own articles of incorporation.

Specific language must be contained in your organizing documents if you will be applying for tax-exempt status with the Internal Revenue Service (IRS) (see Question 8 below). For more information, refer to IRS Publication 557, "Tax-Exempt Status for Your Organization."

Copies of the organization's organizing documents, including any amendments to those organizing documents, should be kept in the organization's permanent records.

NOTE: Act 161, Session Laws of Hawaii 1999, provides for unincorporated nonprofit associations to be treated as a legal entity with (a) authority to acquire, hold, and transfer real and personal property; (b) authority to sue and be sued; and (c) contract and tort liability separate from its officers and members such that the officers and members are afforded limited liability. It also allows, but does not require, unincorporated nonprofit associations to file with the Department of Land and Natural Resources' Bureau of Conveyances a statement of authority to transfer an estate or interest in real property in the name of the nonprofit association and/or a statement appointing an agent authorized to receive service of process. For more information, contact the Bureau of Conveyances at 808-587-0147.

2. A savings institution said that we had to provide our organization's identification number before we could open checking and savings accounts. What number is this and how do we get one?

The organization needs to obtain a federal Employer's Identification Number (EIN) from the IRS even if it does not have any employees. The EIN is referenced on tax returns, income statements, and other tax documents filed by, for, or regarding your organization. See IRS Publication 1635, "Understanding Your EIN," for more information.

To apply for an EIN, complete Form SS-4, Application for Employer Identification Number, and mail it to the IRS. You will receive your EIN by mail in approximately 4 weeks.

3. Is there a faster way to obtain our EIN?

To receive an EIN immediately, you may telephone the IRS' Tele-TIN number after completing Form SS-4, and receive your EIN over the phone. You must mail or fax your signed Form SS-4 to the Tele-TIN Unit of the IRS Service Center for the State within 24 hours. See the instructions for Form SS-4 for telephone numbers and additional information.

NOTE: Although various State offices, including the Oahu District Tax Office and the Business Action Center on Oahu, are authorized by the IRS to issue temporary EINs over-the-counter, they are not authorized to issue an EIN to a nonprofit organization.

4. Our organization is affiliated with a larger organization. Do we need our own organizing documents and EIN, or do we just use those of the larger organization with which we are affiliated?

The answer depends on whether the larger organization is a central organization, and whether your organization is a subordinate organization of that central organization.

A central organization (also known as a "parent" or "umbrella" organization) is an organization that has one or more subordinate organizations under its general supervision or control.

A subordinate organization is a chapter, local, post, or unit of a central organization. The subordinate organization may pay dues to the central organization, have adopted the by-laws of the central organization, incorporate the central organization's name into its name, etc., but it is still a

separate entity that is responsible for its own operations, budget, and taxes.

If the larger organization is a central organization, and if your organization is a subordinate organization of that central organization, then your organization must have its own organizing documents and EIN.

If your organization is not merely under the general supervision and control of the larger organization but is instead directly controlled as an integral part of the larger organization, then your organization is not a separate organization, but is instead a part of the larger organization. In this case, your organization and the larger organization actually are one and the same, and your organization will not have its own organizing documents or EIN.

NOTE: A central organization may also be subordinate to another central organization. For example, a central, state-wide organization that has subordinate organizations at various schools may itself be a subordinate organization of a central national organization.

5. The school sponsors numerous student clubs, teams, and other student-activity groups that are part of the school. Does each club, team or other organization need its own EIN?

No. Student clubs, teams, and other school-sponsored, student-activity groups do not need their own EIN because they are part of the school itself.

School-sponsored, student-activity groups may include the student government, athletic, math and debate teams, band, orchestra, choir, drama, and other performing groups, foreign-language clubs, honor societies, "pep" squads, and other student-activity groups that come under the purview and control of the school.

Parent-teacher organizations, athletic and band booster organizations, and other similar organizations usually are separately organized and therefore are NOT school-sponsored, student-activity groups. Although these organizations may work closely with school administrators, faculty, and students in support of the students and their activities, they are not part of the school itself and need their own EIN.

6. Are nonprofit organizations automatically exempt from paying all taxes?

No. Nonprofit organizations are NOT automatically exempt from all taxes. A number of requirements must be met before they can achieve tax-exempt status. See Tax Facts No. 98-3, "Tax Issues for Hawaii Nonprofit Organizations," for more information.

NOTE: Government entities such as public schools, including public-school-sponsored, student-activity groups (see Question 5 above), are automatically exempt from ALL taxes on ALL types of income. Government entities do not need to file any applications for exemption or pay any taxes on their income.

7. Which taxes do parent-teacher organizations and other nonprofit, school-related organizations usually obtain exemptions from?

Nonprofit, school-related organizations usually obtain tax exemptions from the federal income tax and also from the Hawaii income and general excise taxes.

Federal and State income taxes are sometimes called "net income" taxes because only the taxpayer's net income (i.e., the taxpayer's total income less associated expenses) is subject to taxation. The Hawaii general excise tax is sometimes called a "gross income" or "gross receipts" tax because the taxpayer's gross income (i.e., total income before deducting any expenses) is subject to taxation.

INCOME TAX

Applying for Income Tax Exemption

8. How do we apply for exemption from the federal income tax?

Nonprofit, school-related organizations generally qualify for exemption from federal income tax as charitable or educational organizations described in section 501(c)(3) of the federal Internal Revenue Code (IRC). To apply for an exemption from the federal income tax, these types of organizations should complete federal Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, and Form 8718, User Fee for Exempt Organization Determination Letter Request. Submit these forms and the required fee to the IRS.

After approving your exemption, the IRS will issue a determination letter to the organization; keep this letter in your organization's permanent records.

NOTE: Some organizations described in section 501(c)(3), IRC, may be considered tax-exempt for federal income tax purposes without having to file Form 1023. For example, an organization is not required to file Form 1023 if it is not a private foundation and does not have gross receipts of more than \$5,000 per year. Such organizations may nonetheless want to file Form 1023 so that there is no question by government authorities, potential donors, and others, about the organization's exempt status.

NOTE: Organizations must make their exemption applications available for public inspection.

For more information, refer to IRS Publication 557, "Tax-Exempt Status for Your Organization."

9. Our organization is a subordinate organization of a central organization that already has obtained tax-exempt status with the IRS. Do we need to submit our own income tax exemption application to the IRS or are we automatically covered under the central organization's exemption?

The exemption granted the central organization will NOT automatically cover your subordinate organization. Your organization must submit a separate exemption application unless the central organization applies for a group exemption that includes your organization.

To apply for a group exemption, the central organization must submit a letter to the IRS providing certain information

about the subordinate organizations it wants to include in the group exemption. The IRS subsequently will issue a group exemption letter to the central organization. A copy of the group exemption letter should be kept in the subordinate organization's permanent records.

NOTE: To maintain a group exemption letter, the central organization must annually submit to the IRS certain required information regarding their subordinate organizations. The required information is due at least 90 days before the close of the central organization's fiscal year. For more information, see IRS Publication 557, "Tax-Exempt Status for Your Organization."

10. How do we apply for exemption from the Hawaii state income tax?

For income tax purposes, Hawaii automatically recognizes the tax-exempt status of nonprofit organizations that have been granted tax-exempt status by the IRS as section 501(c)(3), IRC, organizations. Hawaii does not have a separate income tax exemption application form and does not require organizations to submit a copy of their Form 1023 or IRS exemption letter to the Department of Taxation.

CAUTION: The income tax exemption granted by the IRS is not applicable to the Hawaii general excise tax. See Question 24 below.

11. The exemption letter we received from the IRS states that our organization does not have to file a Form 990. What is a Form 990 and when would one be filed?

Form 990 is a federal informational return that tax-exempt organizations other than private foundations file to inform the IRS of its income, expenses, and activities for the year. A short form, Form 990-EZ, may be used in lieu of Form 990 in some instances. Forms 990 and 990-EZ are due on the 15th day of the 5th month after the end of the organization's fiscal year. Central organizations may file a group return for 2 or more subordinate organizations.

Tax-exempt organizations other than private foundations must file Form 990 or Form 990-EZ unless they meet one of the exceptions. For example, an exempt organization having gross receipts that normally do not exceed \$25,000 per year is not required to file Form 990 or Form 990-EZ. However, if an organization that is not required to file receives a Form 990 package with a preaddressed label, then the organization should file the appropriate form even if not required. For more information, see the Instructions for Form 990 and Form 990-EZ.

NOTE: Organizations must make a copy of their Forms 990 and 990-EZ available for public inspection, upon request, for a 3-year period beginning with the filing date. For more information, see IRS Publication 557, "Tax-Exempt Status for Your Organization."

12. Does Hawaii require tax-exempt organizations to file an informational return similar to Forms 990 and 990-EZ?

No. Hawaii does not require the filing of a Form 990, Form 990-EZ, or the equivalent; but see the next section on "Income Tax Filing Requirements."

Income Tax Filing Requirements

13. Does obtaining tax-exempt status with the IRS and the State mean that all of our organization's income is exempt from federal and State income taxes and that we do not have to file any income tax returns?

No. Obtaining tax-exempt status does NOT mean that all of your organization's income is exempt from income taxation. Tax-exempt organizations generally must file an income tax return and pay federal and Hawaii income taxes on their net "unrelated business income" if their unrelated business income is \$1,000 or more.

14. What is "unrelated business income"?

"Unrelated business income" is (a) income from a trade or business that (b) is regularly carried on by an exempt organization and (c) is not substantially related to the organization's exempt purpose.

"Trade or business" generally means an activity that your organization engages in that is intended to generate income from the selling of goods or the performance of services.

An activity is "regularly carried on" if it shows a frequency or continuity, and if it is pursued in a manner similar to comparable commercial activities of regular, for-profit businesses.

An activity is "not substantially related" to an organization's purpose if the activity does not contribute in an important way to the organization achieving its exempt purpose.

Hawaii income tax laws regarding the taxation of tax-exempt organizations described in section 501(c)(3), IRC, follow the federal tax treatment.

There are many special rules regarding the classification of income as unrelated business income. For more information, refer to federal Publication 598, "Tax on Unrelated Business Income of Exempt Organizations."

15. Do most tax-exempt, school-related organizations have to file income tax returns?

No. In many cases, the income that tax-exempt, school-related organizations realize from their activities is not unrelated business income. Frequently, for example, the income is not unrelated business income because the activity is not regularly carried on or the activity is conducted by unpaid volunteers.

EXAMPLE: Income from an annual fundraising sale of chicken, candies, cookies, or other products, and income from an annual school carnival is often not considered unrelated business income because the activity is not regularly carried on in a manner similar to a for-profit business.

16. If our organization does need to file income tax returns, what forms do we file?

File federal Form 990-T, Exempt Organization Business Income Tax Return, with the IRS on or before the 15th day of the fifth month after the tax year ends.

File Hawaii Form N-70NP, Hawaii Exempt Organization Business Income Tax Return, with the State Tax Office on or before the 20th day of the fourth month after the tax year ends.

17. If our nonprofit, school-related organization is not recognized as a tax-exempt organization by the IRS, what tax form must we file and what will the organization be taxed on?

Generally, your organization will be treated as a for-profit corporation, whether it is incorporated or not, and will be required to file a corporation income tax return each year. All income, including membership dues but not donations, must be reported on the income tax return and the net profit taxed at the corporate income tax rates.

The usual federal Corporation Income Tax Return is Form 1120, but the short form, Form 1120-A, may sometimes be used. Forms 1120 and 1120-A are due on or before the 15th day of the third month after the tax year ends. The Hawaii Corporation Income Tax Return is Form N-30, and is due on or before the 20th day of the fourth month after the tax year ends.

Donations

18. May persons who make donations to nonprofit, school-related organizations deduct those donations on their federal and Hawaii income tax returns?

Individuals who make donations to a qualified organization such as a public school (including a public-school-sponsored, student-activity group) or to a school-related organization that is recognized as a tax-exempt organization described in section 501(c)(3), IRC, may claim a deduction for those donations as a charitable contribution on their federal and Hawaii income tax returns.

Individuals claiming charitable contribution deductions must have proof of their donation. For further information, see IRS Publication 526, "Charitable Contributions."

19. If someone makes a donation to a qualified organization (see Question 18 above) and receives something in return, can the donor still deduct the entire amount paid to the organization?

No. A qualifying charitable contribution is a gift to a qualified organization that is voluntarily made without receiving or expecting to receive anything of equal value in return. If the individual receives goods or services in return for their donation, then the individual generally may deduct only the amount of their contribution that is more than the value of the benefit received.

20. If the qualified organization gives donors a small item as a token of appreciation, must the donor take the value of that item into consideration when claiming a charitable contribution deduction?

Donors may claim the full amount of their contribution if (a) the benefit received is a small item or other benefit of

token value and (b) the organization informs the donor that this is the case and that the payment may be deducted in full.

The organization must determine if the item or benefit is of token value by using the guidelines stated in IRS Revenue Procedures 90-12 and 92-49.

21. If a person purchases a fundraising ticket for a product or program but does not redeem or use the ticket, can the person deduct the full purchase price of the ticket as a charitable contribution?

No. If an individual purchases a ticket for goods or services but fails to redeem or use that ticket, the individual will not be able to deduct the amount paid for the unredeemed ticket as a charitable contribution.

However, if the individual returns the ticket to the organization for resale, then the full amount paid to the organization may be deducted.

22. Are the annual membership dues paid to tax-exempt organizations deductible on federal and Hawaii income tax returns?

Members may deduct the annual membership dues paid to a qualified tax-exempt organization as a charitable contribution on federal and Hawaii income tax returns.

If members receive any benefits, they may deduct only the amount that exceeds the value of the benefits received. However, certain membership benefits may be disregarded if the annual membership payment is \$75 or less.

For more information, see IRS Publication 526, "Charitable Contributions."

23. What kind of written statements must organizations furnish to donors?

Organizations should furnish statements to donors in a number of instances. For example, a written statement should be furnished to donors who make a payment that is more than \$75 and is partly a contribution and partly for goods or services, for cash contributions of \$250 or more, and for all noncash contributions.

For more information, see IRS Publication 526, "Charitable Contributions," and Publication 557, "Tax-Exempt Status for Your Organization."

HAWAII GENERAL EXCISE TAX

Applying for General Excise Tax Exemption

24. How do we apply for exemption from the general excise tax?

Nonprofit, school-related organizations generally qualify for exemption from general excise tax as organizations described in section 237-23(a)(4), Hawaii Revised Statutes (HRS).

To apply for general excise tax exemption, complete Form G-6, "Application for Exemption From General Excise Taxes," and submit the application, copies of the articles of organization, by-laws, and IRS determination letter, and \$20 registration fee to the Technical Section of the Department of

Taxation's Taxpayer Services Branch. The \$20 fee is waived if your organization applied for a Hawaii general excise tax license and paid the \$20 license fee at that time (see Question 56 below).

A letter and a certificate will be sent to the organization upon approval. Both the letter and the certificate should be kept as part of the organization's permanent records.

NOTE: Certificates were not issued prior to 1990, but an exemption letter was sent and should be in the organization's permanent records.

For more information, see Tax Information Release No. 89-13, "Application for Exemption from the Payment of General Excise Taxes for Nonprofit Organizations."

25. Are high school alumni class organizations (e.g., School X Class of YYYY) considered school-related organizations eligible for exemption from the general excise tax under section 237-23(a)(4), HRS?

No. High school alumni organizations whose membership consists of the graduates of a particular school during a particular year generally are considered social organizations rather than educational or charitable organizations. Social organizations do not qualify for exemption from the general excise tax.

NOTE: Social organizations such as high school alumni organizations are not organizations described in section 501(c)(3), IRC. They may be exempt from income tax as an organization described in under section 501(c)(7), IRC. If the high school alumni organization is recognized by the IRS as a tax-exempt organization described in section 501(c)(7), IRC, Hawaii also will recognize the exemption for purposes of the Hawaii income tax, but not the general excise tax. For more information, see IRS Publication 557, "Tax-Exempt Status for Your Organization."

26. Do we need to wait until we get the IRS letter before submitting the State application?

No. Submit the exemption application, Form G-6, as soon as possible even if the IRS has not yet issued a determination letter to the organization.

The Department can grant the organization a conditional exemption pending receipt of the IRS letter. The conditional exemption will be changed to a permanent exemption when you send to the Department a copy of the IRS exemption letter.

27. How long is the conditional exemption good for?

The conditional exemption is good for one year from the date of the letter notifying you of the conditional approval. During this period, your organization should receive the exemption letter from the IRS. When it is received, send a copy to the Technical Section of the Department's Taxpayer Services Branch, and your exemption will be changed from a conditional exemption to a permanent exemption.

If there is a delay in obtaining the exemption letter from the IRS and additional time is needed, please contact the Technical Section as extensions may be granted.

28. As of what date is the general excise tax exemption effective?

If the application is filed within 3 months of the commencement of business in Hawaii, then the exemption will be effective as of the date the organization commenced its activities in Hawaii.

If the application is filed on or before March 31, the exemption will be effective as of January 1 of that year.

For good cause, the Department may extend these registration periods for no more than 2 months. However, if the application is filed after these registration periods, then the exemption will be effective as of the date the application is submitted to the Department of Taxation.

29. Our organization has been in existence for many years but has never applied for the general excise tax exemption. May we ask that our exemption be granted retroactively to the date our organization began?

No, the law does not permit the Department to grant retroactive exemptions, but see Questions 66 and 67 below.

30. Once the organization has its general excise tax exemption, will stores and other vendors stop charging us sales tax?

Actually, there is no sales tax in Hawaii. Although many people think that the general excise tax is a sales tax, that is in fact not so.

Sales taxes are levied on consumers who purchase goods at retail; sellers are required to charge and collect from their retail customers a specified percentage of the sales price as tax and remit the sales tax collected to the state and/or locality that is levying the tax.

The general excise tax, on the other hand, is levied on businesses for the privilege of doing business in the State and is computed as a percentage of the gross income that the business derives from its business activities in Hawaii.

Because the general excise tax is levied on the business that is receiving the income rather than on the customer, a for-profit business must pay the general excise tax on all of its gross income, including income that it derives from customers that are exempt from the general excise tax. Therefore, businesses may pass on the general excise tax to customers as part of the sales price of the goods and services regardless of whether the customer is tax-exempt or not.

Obtaining a general excise tax exemption only means that your organization does not have to pay the general excise tax on certain types of income that it receives.

For more information, see Tax Facts No. 96-1, "General Excise vs. Sales Tax."

31. If an organization obtains tax-exempt status for general excise tax purposes, is all of its income exempt from the tax?

No. Obtaining tax-exemption from the general excise tax does NOT mean that all of the organization's income is exempt from the tax. The organization is exempt from paying the general excise tax on income that is (a) derived from its activities that fulfill its exempt function as a school-related organization and (b) that do not have as a primary purpose the production of income.

NOTE: Gross income from activities that fail to meet one or both conditions for exemption will be subject to the general excise tax even if all of the money raised will be used to pay for school-related expenses.

32. Is the "unrelated business income" discussed above in Question 14 the same kind of income that is subject to the general excise tax?

No, there are many differences. For instance, "unrelated business income," as defined for income tax purposes, must be from activities that are regularly carried on. For general excise tax purposes, even one fundraiser a year will be taxable.

EXAMPLE: Parent-teacher organization A has obtained its exemption from the general excise tax. Parent, teacher, and student volunteers conduct a cookie sale fundraiser during the month of October. The net income derived from the cookie sales IS NOT taxable for income tax purposes (i.e., it is NOT unrelated business income) because the activity is not regularly carried on. For general excise tax purposes, however, the gross income derived from the cookie sale IS taxable.

33. During our annual school fair, donated goods are sold at the fair's Country Store. For income tax purposes, the sale of donated goods is not considered unrelated business income and is therefore exempt from federal and State income tax. Is it also exempt from the general excise tax?

No, the sale of donated goods is not exempt from the general excise tax. This is another instance in which the definition of "unrelated business income" for income tax purposes is not applicable to the general excise tax.

For more information, see Tax Information Release No. 91-2, "Taxability of Gross Proceeds Received by a Nonprofit Organization From the Sale of Donated Services or Tangible Personal Property."

34. What are other examples of income subject to the general excise tax?

Generally, income from fundraising activities such as cookie, chicken, pizza, or other food product sales, car washes, auctions, and school fairs is subject to the general excise tax at the rate of 4%. Income from advertising placed in organization directories or newsletters also is subject to the general excise tax at the rate of 4%.

35. What types of income are NOT subject to the general excise tax?

The following types of income generally may be exempted from the general excise tax by a school-related organization recognized as tax-exempt for purposes of the general excise tax:

- membership dues
- donations
- interest earned on federally insured bank accounts, including certificates of deposit, into which the organization's funds have been placed for "safe keeping" (as opposed to a trade or business activity)

- nominal fees charged for parenting workshops sponsored by a parent-teacher organization
- nominal fees charged for participation in athletic camps sponsored by athletic booster organizations
- nominal fees charged for participation in music workshops sponsored by a band booster organization

36. If an organization does not apply for and receive an exemption from the general excise tax, what will it be taxed on?

If a nonprofit organization does not obtain exempt status for purposes of the general excise tax, then all income which it receives will be subject to the general excise tax except those types of income specifically exempt from the general excise tax (e.g., membership dues, donations, and interest from bank accounts into which the organization's funds have been placed for "safe keeping" as opposed to a trade or business activity).

37. If a central organization has a number of subordinate organizations but also operates a number of programs itself, can the central organization file one general excise tax exemption application to cover itself, its programs, and its subordinate organizations?

In this case, an exemption from general excise tax obtained by the central organization will cover all of the programs that it operates, but will not apply to any separately organized subordinate organizations.

The general excise tax is imposed on any entity regarded as such under the law (e.g., corporation, limited liability company, association, etc.). Therefore, subordinate organizations that treat themselves as entities separate and apart from the central organization must obtain their own general excise tax exemption. Factors such as having its own organizing documents, checking account, EIN, etc., indicate separate entity treatment.

However, if an organization operates programs that it directly controls as integral parts of the organization itself, then there is only a single entity. In this case, when the organization applies for and obtains exemption from the general excise tax, the exemption granted will apply to the entire organizational entity.

Fundraising

38. If an organization is recognized as tax-exempt for purposes of the general excise tax and all of the fundraising proceeds are used to buy equipment, books, supplies, and other things for the school and to otherwise further the organization's tax-exempt purpose, why should it pay the general excise tax on the fundraising income?

When determining whether income is subject to the general excise tax or not, the Department must look at the activity which generated the income rather than what the organization does with the income.

If the tax-exempt organization engages in a for-profit business activity, then the tax-exempt organization is taxed

in the same manner in which a for-profit business would be taxed on that same activity. It is not the intent of the law for tax-exempt organizations to unfairly compete with for-profit businesses. If a tax-exempt organization sells candy at a profit as a fundraiser, it will be subject to the same general excise tax as a for-profit retail store selling that same candy.

39. If a school-related organization that is recognized as tax-exempt for purposes of the general excise tax conducts a fundraiser and then gives the money to the school instead of buying things for the school, would the proceeds still be subject to the general excise tax? Would it make any difference if the school was a public school rather than a private school?

If the tax-exempt organization engages in a for-profit business activity, the organization will be subject to the general excise tax regardless of whether cash or tangible items are given to the school, or whether they are given to a public or private school.

40. If a school conducts a fundraiser that is run by volunteers from a school-related organization, will the school or the organization be subject to the general excise tax?

If the school conducts the fundraiser, then the school, not the school-related organization, will be subject to the general excise tax on gross income derived from the fundraiser. However, care should be taken to ensure that all advertising, tickets, contracts or agreements, and other written documents show that the school is conducting the fundraiser. In addition, necessary disbursements should be made from school accounts, and all payments should be paid directly to the school (i.e., checks should be made payable to the school and cash directly deposited into the school's account).

NOTE: If a PUBLIC school conducts a fundraiser in which all of the proceeds are paid into, processed, and disbursed from the school's non-appropriated school fund checking account, then no general excise tax is due because the public school, as a government entity, is not subject to taxation. Public-school-related organizations may avoid federal and State tax issues by conducting their activities in the manner described above. Also see Question 41 below.

41. If a school-sponsored, student-activity group conducts a fundraiser, does the 4% general excise tax have to be paid? If so, who pays the tax?

If a private-school-sponsored, student-activity group conducts a fundraiser, then the 4% general excise tax must be paid by the private school that sponsors the group.

If a public-school-sponsored, student-activity group conducts a fundraiser in which all of the proceeds are paid into, processed, and disbursed from the school's non-appropriated school fund checking account, then no general excise tax is due because the public school, as a government entity, is not subject to taxation. For more information, see Tax Information Release No. 89-6, "General Excise Tax on the Fund-Raising Activities of Public School Sponsored Groups."

42. When school-related organizations sell products such as food items, books of coupons, or holiday wreaths as a fundraiser, the profit to the organization is only a portion of the total sales price. Could the profit portion be considered a sales commission? If it is a commission, does the organization pay the general excise tax on the full sales price or only upon the commissions earned?

In most cases, the organization is engaging in a retail sales transaction in which the full sales price is subject to the general excise tax.

However, if the organization is NOT buying and reselling the products, but is instead merely acting as a sales representative of the actual seller of the product, then the amount retained by the organization may be a sales commission. In this case, the school-related organization will be subject to the general excise tax on its commissions only.

EXAMPLE: Organization X buys boxes of candy bars from Company A for \$0.50 a bar and resells the candy bars for \$0.75 each. Organization X is engaging in a retail sales activity and will be subject to the general excise tax at the rate of 4% on the full sales price of \$0.75 per bar.

EXAMPLE: Company B will be shipping holiday wreaths to Hawaii for sale at \$25 per wreath in early December. Organization Y enters into an agreement with Company B to take orders for Company B's wreaths for pick-up at Organization Y's location the first Saturday in December. Any excess wreaths delivered to Organization Y's pick-up site will be taken away by Company B. In return, Organization Y will receive a certain percentage of the sales as a commission. Organization Y does not buy the wreaths for resale, but merely acts as a sales representative for Company B. Therefore, Organization Y will be subject to the general excise tax on the commissions earned only.

43. Some Internet sellers tell purchasers that a portion of the sale price will be donated to a designated charitable organization such as a school-related organization. Is a school-related organization subject to the general excise tax on income received from the Internet sellers?

Generally, the income is considered a donation and is not subject to the general excise tax.

However, if the school-related organization acts as a sales representative on behalf of the Internet seller, then the income is considered a sales commission subject to the general excise tax at the rate of 4%.

44. Our organization holds an annual fundraising craft fair. Crafters are charged a fee to participate in our craft fair. Are the fees subject to the general excise tax, and if so, how are they reported?

The fees received from the crafters are subject to the general excise tax irrespective of whether it is called a fee, charge, rent, etc. Report the fees as "Other Income" taxable at the rate of 4%.

45. The student council for our school holds an annual Book Fair at which a book publisher is allowed to display children's books in the library which children may

purchase. Checks for the books purchased are made payable to the publishing company. At the end of the Book Fair, the publishing company donates a number of books to the school based on the amount sold. Is any general excise tax due as a result of the Book Fair?

In this situation, the school is subject to the 4% general excise tax on the fair market value of the books which it received (note that the student council is a school-sponsored, student-activity group and that the income is reported by the sponsoring school). The books given to the school are not considered a non-taxable donation because they were received in exchange for allowing the book company to display the books and make sales at the school.

NOTE: If the school is a public school, no general excise tax is due because it is a government entity not subject to taxation.

46. As a fundraiser, our organization sells Product X for \$5. The fair market value is \$4, so people who buy Product X from us can claim a deduction of \$1 as a charitable donation on their federal and State income tax returns under IRS rules. Is the organization subject to the general excise tax on the entire \$5 or only the \$4 fair market value?

The organization is subject to the 4% general excise tax on the entire \$5.

What a donor may deduct for income tax purposes is not the same as what an organization may consider a tax-exempt donation for general excise tax purposes. For income tax purposes, a deductible donation is the amount of the donor's payment to a qualifying organization that EXCEEDS the value of any property or service received in return. For general excise tax purposes, a tax-exempt donation is the amount which a donor makes to a tax-exempt organization WITHOUT RECEIVING OR EXPECTING TO RECEIVE ANYTHING in return.

Since the purchaser of Product X expects to get Product X in return for the \$5 paid to your organization, the \$5 received by the organization is taxable.

47. If our organization sells fundraiser tickets for \$10, but someone chooses to give us \$25 instead, must our organization pay the general excise tax on the \$10 sales price or the \$25 we actually were given?

In this instance, the purchaser voluntarily paid your organization \$15 more than what the ticket was being sold for. Therefore, your organization only needs to pay the general excise tax on the \$10 sales price of the ticket. The additional \$15 received may be treated as a nontaxable donation to the organization for general excise tax purposes.

48. If an organization holds a "free" car wash at which people merely are asked to give a donation, will the money donated at the car wash be exempt from the general excise tax?

No. Although the car wash is advertised as a "free" service, the actual intent of the car washing activity is to raise funds. As a fundraising activity, it is reasonable to expect that those having their cars washed would pay a certain amount for that service. If there is a reasonable expectation

of exchange (e.g., cash in exchange for the car wash) reasonably measured (e.g., a fundraising activity in which the general public is targeted), then a reasonable amount received in exchange for the car washing service (i.e., the fair market value) will be subject to the 4% general excise tax.

Other examples include doing yardwork or other tasks, handing out “free” snacks at tourist spots, and other activities for which the organization can reasonably expect to receive monetary compensation of various amounts.

49. One of our fundraisers is the sale of tickets for Product Z which ticket holders pick up on a certain day. If we call the \$10 sales price of the ticket for Product Z a “donation,” will it still be subject to the general excise tax?

The \$10 sales price is subject to the general excise tax at the rate of 4% regardless of what it is called.

A donation is a gift that is voluntarily made without receiving or expecting to receive anything in return. If by giving you \$10, the purchaser receives a ticket which entitles the bearer to receive Product Z, then the \$10 paid to the organization is not a donation but merely the sales price of Product Z.

NOTE: In this situation, the organization may NOT call the entire \$10 sales price a tax deductible “donation” as it misrepresents the nature of the payment made to the organization. Only the portion that exceeds the value of the product may be represented as a donation (see Question 19 above). For further information on what may constitute a misrepresentation to purchasers, contact the Office of Consumer Protection of the State Department of Commerce and Consumer Affairs at 808-587-3222.

50. Our organization conducts a fundraising drive during which donations are solicited to support our programs. In appreciation, we offer gifts to the donors which may be accepted or not. Depending upon the amount of the donation, the gift could be a school logo bumper sticker, T-shirt, hat, coffee mug, or canvas bag. Gifts also may include donated items such as gift certificates to restaurants, book or video stores, hotel accommodations, and the like. Sometimes the donors can choose which gift they prefer. Do we have to pay the general excise tax on these donations just because we give gifts to the donors?

If the gift is of nominal value, then the amount received by your organization is considered a nontaxable donation. If the gift is NOT of nominal value, then the donation is really a sale and will be subject to the 4% general excise tax.

“Nominal value” is not specifically defined for purposes of the general excise tax. However, the Department will treat a gift as being of nominal value if the fair market value of the gift is less than \$1.

If the gift is not of nominal value, then the transaction will be classified as a retail sale in which the minimum “donation” needed to receive the gift will be considered the sales price subject to the 4% general excise tax.

51. Our school-related organization holds an annual Read-a-Thon in which the students solicit pledges from

sponsors who pay the organization a certain amount of money based on the number of books that the sponsored student reads. Is the income that we receive from the Read-a-Thon subject to the general excise tax?

No. In this case, sponsors do not receive anything of monetary value in exchange for their pledges. The amount paid by sponsors to your organization is considered a donation that is not subject to the general excise tax.

Similar fundraising events that also are not subject to the general excise tax include walk-a-thons, jog-a-thons, and jump-rope fundraisers.

52. Our organization annually designs and has printed school logo T-shirts, sweatshirts, canvas bags, and caps which are sold to parents, students, and school faculty. Are these sales subject to the general excise tax?

If your organization is recognized as tax-exempt for purposes of the general excise tax, the income derived from the sales of the school logo products will not be subject to the general excise tax provided that the sales prices are at a level to recover the organization’s costs from these products. Such sales fulfill the organization’s exempt function and do not have as a primary purpose the production of income (see Question 31 above).

However, if the school logo products are sold as a revenue producing activity at a price that substantially exceeds their cost to the organization, then these sales will be taxable.

53. Our parent-teacher organization operates a before-school care program at the elementary school. Are fees (that we keep as low as possible) paid by the parents subject to or exempt from the general excise tax?

If your organization is recognized as tax-exempt for purposes of the general excise tax, then the fees paid by the parents to your organization will be exempt from the general excise tax.

NOTE: If your organization has or will have employees, then it must withhold federal and State income taxes from the employees’ wages, and comply with other employer related requirements that are not covered in this publication. Contact the IRS (1-800-829-1040), the Department of Taxation (see numbers at the end of this publication), and the State Department of Labor and Industrial Relations (808-586-8914) for further information.

54. Is income that our school-related organization receives from recycling paper, plastic, glass, and aluminum subject to or exempt from the general excise tax?

Income from recycling is not exempt from the general excise tax because it is, on its face, primarily an income producing activity.

However, if the organization can demonstrate that the actual recycling is part of a larger program (e.g., the City & County of Honolulu’s “Recycle Hawaii” program) that fulfills the organization’s exempt function or purpose (other than the mere fact that the funds are used to further the organization’s exempt purpose), and that the production of income is NOT

the primary purpose of the recycling program (see Question 31 above), then the recycling income may be exempt from the general excise tax.

55. A group of students is planning a trip to the mainland and our booster organization is supporting the fundraising. Is there a problem if each student is credited with the profits from the sales which that student makes during the fundraiser?

Yes. One of the requirements for being a nonprofit organization is that no part of the net earnings of the organization may inure to the benefit of any of its members, trustees, officers, or other private persons except under certain limited circumstances.

If a student is credited with the profits of his or her sales, the prohibition against private inurement may be violated.

General Excise Tax Registration and Filing Requirements

56. How do we register to pay the general excise tax?

To register for the general excise tax, complete Form BB-1, Basic Business Application, and submit the application with the \$20 license fee to the Department of Taxation. A license certificate and a booklet of general excise tax forms and instructions will be mailed to the organization approximately 6 weeks after the application is filed.

NOTE: The \$20 fee is waived if your organization has applied for the general excise tax exemption and paid the \$20 fee with Form G-6 (see Question 24 above).

57. Our current officers do not know for sure if our organization has a general excise tax license or not. How can we check?

You may call any district tax office to see if the organization has a general excise tax license. If so, a duplicate license certificate may be requested.

Your organization may not be receiving its tax forms because the information that the Department has on its records is obsolete. Frequently, an organization's mailing address will change from year to year as its officers change. As a result, the booklet of tax forms mailed each year to licensees may not actually reach the organization after a few years.

It is important that the information included on the original application form be regularly updated. Forms for this purpose are included in the booklet of general excise tax forms. Use Form GEW-TA-RV-2, Change of Address Form, to change the organization's mailing address, and Form GEW-TA-RV-5, the application changes form, to make other changes such as adding and deleting officers, changing telephone numbers, etc.

58. What kinds of general excise tax returns must be filed, and when are they due?

Two kinds of general excise tax returns are required; periodic returns (Form G-45) and annual returns (Form G-49).

Periodic returns are filed monthly, quarterly, or semiannually. Semiannual returns may be filed if the annual general excise tax paid by the organization is \$1,000 or less. Quarterly returns may be filed if the annual general excise tax paid by the organization is \$2,000 or less. Monthly returns are required if the annual general excise tax paid by the organization is more than \$2,000. These periodic returns are due one month following the close of the tax period. For example, the periodic return for the quarter of October, November, and December is due on or before the last day of the following January.

The annual general excise tax return summarizes the organization's income and deductions, tax liability, and payments for the year, and is due on or before the 20th day of the fourth month after the tax year ends. For example, if an organization's fiscal year is July 1 through June 30, the annual return will be due on or before October 20.

If a due date falls on a weekend or a State of Hawaii holiday, then the organization's general excise tax returns will be considered "filed on time" if filed by the next following work day.

For more information, see the brochure entitled, "An Introduction to the General Excise Tax."

USE TAX

59. I looked at the general excise tax forms and noticed that the forms also mention another tax called the use tax. What is the use tax?

The use tax is a tax on the value of tangible personal property and services that are imported into Hawaii for use in Hawaii. The purpose of this tax is to ensure that Hawaii businesses that pay the general excise tax are not at a price disadvantage when competing for business with out-of-State businesses that are not subject to the general excise tax.

For example, a Hawaii consumer could purchase a computer from a local seller or from an out-of-State seller through a catalog or via the Internet. If the out-of-State seller is not doing business in Hawaii and is therefore not subject to the general excise tax, then the out-of-State seller could sell the computer for less than a local seller that is subject to the 4% general excise tax could sell that same computer. The use tax eliminates this price disadvantage by requiring the Hawaii consumer to pay a tax on the value of the computer purchased from the out-of-State seller; the use tax rate is the same general excise tax rate that a local seller would have paid. In this example, the use tax is 4% of the value of the computer.

NOTE: Prior to January 1, 2000, the use tax is levied on the value of imported tangible personal property only. Effective January 1, 2000, however, the use tax also is levied on the value of imported services (Act 70, Session Laws of Hawaii, 1999).

60. Can a nonprofit, school-related organization obtain tax-exempt status for the use tax?

No. Tax-exempt status is not allowed for purposes of the use tax.

61. What are the use tax rates?

No use tax is levied when tangible personal property or services are imported for resale in a transaction that is subject to the general excise tax at the rate of 0.5%.

The use tax is 0.5% on the value of tangible personal property or services imported into Hawaii for resale in a transaction that is subject to the general excise tax at the rate of 4%.

The use tax is 4% in all other cases.

62. How do we compute the use tax?

The use tax is computed by first determining what the value of the imported tangible personal property or services is, and then multiplying that value by the applicable rate. The value of the goods or services is determined as of the time the goods or services arrive in Hawaii. This includes the cost of the goods or services, shipping, handling, and other associated costs except sales taxes paid in another state.

EXAMPLE: Parent-teacher Organization X purchases a set of educational videos for the school library from an out-of-State seller that is not subject to the Hawaii general excise tax. The cost of the videos is \$300 plus \$10 shipping and handling. The landed value is \$310; the use tax rate is 4% because the videos will not be resold in a transaction subject to the general excise tax; the total use tax due is \$12.40 ($\$310 \times 0.04 = \12.40).

NOTE: If the videos had been purchased from a Hawaii seller, the Hawaii seller would have paid the State 4% of its gross income from that retail sale. Therefore, the comparable use tax rate also is 4%.

63. Our school-related organization holds a fundraiser each year in which we sell personalized stationary, pencils, and pens. After we take the orders from customers, we send the orders to an out-of-State company that does the personalization and ships the orders directly to our customers. Since the personalized orders are shipped directly to our customers instead of to our organization, does our organization have to pay any use tax? If so, does it pay the use tax on the price paid to the out-of-State company or on the price that the items were sold to our customers for?

Your organization must pay the use tax because your organization caused the goods to be imported even if the goods by-passed your organization and were shipped directly to your customers.

The value of the imported items upon which the use tax is levied is the amount paid to the out-of-State company, including any shipping and handling charges, and NOT what the items were sold to your customers for.

NOTE: The applicable use tax rate in this case is 0.5% since the imported stationary, pencils, and pens are imported for resale in a transaction that is subject to the general excise tax at the rate of 4%.

64. Our school-related organization sometimes buys books from out-of-State sellers on topics such as

parenting, child development, and the like, and sells them at a nominal cost to parents. We are reselling the books but do not have to pay any general excise tax on those sales because they fall under our general excise tax exemption. What use tax rate will apply in this situation?

The use tax rate in this situation is 4%.

Gross income from the sales of the imported books are not subject to the general excise tax since the organization is tax-exempt with respect to those sales; therefore, the 0.5% use tax rate is not applicable.

65. How do we report and pay the use tax?

Most school-related organizations that are subject to the use tax also must register for the general excise tax. Registering for the general excise tax (see Question 56 above) automatically registers the organization for the use tax.

The value of imported goods and services is reported on the same tax return forms that are used to report and pay the general excise tax (see Question 58 above).

For more information on the Hawaii use tax, see the brochure entitled, "An Introduction to the Use Tax."

COMPLIANCE ISSUES

66. Our organization was not previously aware of the various income tax, general excise tax, and use tax requirements and now find that the organization has a lot to do to catch up. The problem is that we don't have many records for earlier years. What should we do?

You should make a good faith effort to file complete and accurate tax returns for all outstanding years, and pay any tax, penalties, and interest. If the records are unavailable, then a fair estimate should be made.

67. Our organization has been in existence for a very long time and there is no hope of even coming up with an estimate for a number of years. We also don't know if we can pay all amounts that may be due at the present time. What will happen to our organization if we cannot fully comply with the tax laws?

Contact your district tax office for assistance. Special accommodations may be considered on a case-by-case basis if an organization demonstrates a good faith effort to bring the organization into compliance.

68. If we are uncertain of what the tax consequences of some of our activities are, can we obtain a ruling from the Department of Taxation?

Yes. Rulings may be obtained by writing to the Technical Section of the Taxpayer Services Branch at P.O. Box 259, Honolulu, Hawaii, 96809-0259. Form A-7, Request for a Ruling, also may be used for this purpose.

The letter or Form A-7 must be signed by an officer of the organization. If signed by someone other than an officer of the organization, then a valid power of attorney, Form N-848, also must be submitted.

69. Which IRS office can we call for assistance with questions about tax-exempt organizations?

The IRS' centralized customer service office for tax-exempt organizations may be telephoned toll-free at 1-877-829-5500. This office can assist you with any

questions you may have about tax-exempt organizations including the application form and procedures, the status of a submitted application, filing requirements, what constitutes unrelated business income, and more.

FEDERAL AND STATE PUBLICATIONS YOU MAY WANT TO REFER TO

Internal Revenue Service Publications:

(These publications may be obtained by calling 1-800-829-3676, or by visiting the IRS website at <http://www.irs.ustreas.gov>.)

Publication 526, "Charitable Contributions"
Publication 557, "Tax-Exempt Status for Your Organization"

Publication 598, "Tax on Unrelated Business Income of Exempt Organizations"
Publication 1635, "Understanding Your EIN"

Department of Taxation Publications:

(See below for information on obtaining Department of Taxation publications.)

Brochures:

"An Introduction to the General Excise Tax"
"An Introduction to the Use Tax"

Tax Facts:

Tax Facts No. 96-1, "General Excise vs. Sales Tax"
Tax Facts No. 98-3, "Tax Issues for Hawaii Nonprofit Organizations"

Tax Information Releases:

Tax Information Release No. 89-6, "General Excise Tax on the Fundraising Activities of Public School Sponsored Groups"
Tax Information Release No. 89-13, "Application for Exemption from the General Excise Taxes for Nonprofit Organizations"
Tax Information Release No. 91-2, "Taxability of Gross Proceeds Received by a Nonprofit Organization From the Sale of Donated Services or Tangible Personal Property"
Tax Information Release No. 91-4, "Hawaii Tax Obligations of Nonprofit Organizations"

STATE DISTRICT TAX OFFICE ADDRESSES & TELEPHONE NUMBERS

Website (Forms & Information)
<http://www.state.hi.us/tax/tax.html>

CD-ROM (Forms & Information)
Nominal Cost (Limited Supply)

Forms by Mail
808-587-7572
Toll-Free: 1-800-222-7572

Recorded Tax Updates
808-587-1234 and press 7700

Forms by FAX
Oahu: 587-7572
Outside Oahu: 808-678-0522 from your fax machine

Telephone Devices for the Deaf (TDD)
Tax Services & Processing: 808-587-1418
Toll-Free: 1-800-887-8974

Oahu District Tax Office
830 Punchbowl Street
P. O. Box 1425
Honolulu, HI 96806-1425

Maui District Tax Office
54 South High Street, #208
P. O. Box 1427
Wailuku, HI 96793-6427

Hawaii District Tax Office
75 Aupuni Street, #101
P. O. Box 937
Hilo, HI 96721-0937

Kauai District Tax Office
3060 Eiwa Street, #105
P. O. Box 1687
Lihue, HI 96766-5687

Tax Information
Telephone No.: 808-587-4242
Jan.-April 20: 808-587-6515
Toll-Free: 1-800-222-3229
Fax No.: 808-587-1488

Telephone No.: 808-984-8500
Fax No.: 808-984-8522

Telephone No.: 808-974-6321
Fax No.: 808-974-6300

Telephone No.: 808-274-3456
Fax No.: 808-274-3461